



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Persistent pension problems

The state's pension problem has been decades in the making. The root cause has been promising benefits and not paying for them. For example, between 1991 and 2005 the Legislature increased the liability of the Teachers' Retirement System 14 times by increasing benefits without identifying a funding source.

The result was pension systems that, until just recently, ranked among the worst-funded in the nation. In recent years, state policymakers decided to finally tackle the problem that had been kicked down the road for decades. The first action was to stop the problem from worsening. Between 2006 and

2007, laws were enacted to prohibit the Legislature from increasing benefits without funding them and require that any legislation to alter pension benefits include an actuarial analysis stating the true cost of the proposal.

Between 2011 and 2012, additional reforms were enacted to help stabilize the pension plans. The largest reform was to eliminate granting cost-of-living-adjustments (COLAs) without also providing funding to cover the expense. Additional improvements included increasing the minimum retirement age for new workers.

All the reforms are expected to have a positive impact over time, but the only reform that was immediately measurable was the unfunded COLA ban, which overnight reduced the state's collective unfunded liability by \$5 billion. However, a year after that landmark reform, the liability has crept back up by almost \$1 billion due to lower investment returns. And while Oklahoma's pensions are no longer among the worst-funded in the nation, they still rank in the bottom third.

Without additional reform, Oklahoma may be unable to keep the promises

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Funded Status of Oklahoma Public Pensions

Plan	Actuarial Value of Assets (in millions)	Actuarial Accrued Liability (in millions)	Funded Status as of 7/1/2012	Funded Status as of 7/1/2011
Teachers	\$10,190	\$18,588	54.8%	56.7%
Public Employees	\$6,682	\$8,335	80.2%	80.7%
Firefighters	\$1,759	\$2,886	60.9%	63.7%
Police	\$1,834	\$2,034	90.2%	93.0%
Law Enforcement	\$688	\$879	78.3%	75.9%
Judges	\$239	\$249	95.7%	96.4%
Wildlife	\$77	\$101	76.1%	78.1%
Total	\$21,468	\$33,072	64.9%	66.7%

Source: NEPC, LLC



Governor's Commentary

By Governor Mary Fallin

Rightsizing pensions

Since day one, my administration has been working to “right-size” state government. When I took office, the state was in the midst of a budget shortfall and a tough economy, and I called on state agencies to do more with less. Today, Oklahoma’s economy is much stronger, but that doesn’t mean we should stop looking for ways to make government leaner.

Rightsizing means eliminating waste and duplication and identifying opportunities for increased efficiencies.

One of Oklahoma’s greatest successes in rightsizing has been the consolidation of the state’s information technology. During my first year as governor, I called on the Legislature to send me a plan to streamline the state’s information technology services, an area which contained duplicative services and personnel.

During the IT consolidation, there were many who questioned the need and doubted any cost savings could be achieved. The legislation mandated a minimum 15 percent savings. We have already exceeded

that goal and realized a total savings of \$84 million throughout 50 agencies.

We must now focus our rightsizing efforts on our state’s pension systems.

While our state tax-supported bond debt is low, our \$11 billion unfunded pension liability represents seven percent of our Gross State Product.

That means every Oklahoman is on the hook for \$2,900 in pension debt. And it is our pension debt that remains the biggest obstacle to Oklahoma obtaining a AAA credit rating.

Oklahoma’s state pension plans are a promise to public workers – our police, firefighters, teachers, and many others who provide essential public services in areas such as health and human services, transportation and our justice system.

Oklahoma must keep its promise to 220,000 current employees and retirees while making sure future employees are provided an affordable retirement system that meets the needs of a changing public workforce and an overburdened taxpayer.

“We must now focus our rightsizing efforts on our state’s pension systems.”



That is why I want to work with the Legislature to implement two more important pension reforms: first, streamlining the administration of Oklahoma’s pension boards; second, modernizing our pension benefit plan by providing portability, flexibility and choice to future workers and cost certainty to the state.

Currently, Oklahoma has seven pension plans, six of which have independent boards, staff, offices, consultants and investment managers.

Oklahoma spends \$80 million to \$100 million each year just to administer our pensions. Using the state’s past consolidation successes as an example, we can expect at least 15 percent in savings. Over a ten-year period, this change alone could provide an additional \$120 million to \$150 million that could instead be used toward paying retirement benefits.

But more importantly, it would direct the focus on the financial health

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Governor

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of the state and the pension systems as a whole rather than on individual member benefits. A centralized board would not mean that the seven plan's funds would be combined, only the funds' administration, investment and financial oversight. This is similar to the successful shared IT services model we have used throughout state government.

To meet the needs of a modern workforce and provide cost certainty to state government outlays, we must

catch up with the private sector and many other states by moving toward a 401k-style retirement plan that provides portability, flexibility and choice.

When Oklahoma's pension systems were created, it was common for a worker to spend 25 to 30 years in the public sector. Today, the average public employee exits for the private sector much sooner.

When that happens, they often leave their pension contributions behind. Oklahoma should allow workers to earn benefits sooner and to take those benefits

with them as their careers evolve.

As with past efforts to right-size government, there will be those who fight to maintain the status quo. But now is the time to address our unfunded pension debt and right-size Oklahoma's pensions by eliminating duplication and inefficiencies in our current system and developing a fiscally responsible benefit structure for the future.

I look forward to working with our Legislature to finally deliver a responsible, fully-funded pension system.

Pensions

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made to workers without pressure to cut spending in core areas of government, raise revenue, or increase employee contributions.

Additionally, the state's pension liabilities are the greatest threat to Oklahoma's credit rating. A downgrade would result in higher borrowing costs for the state; costs which would be passed on to taxpayers and businesses. Conversely, if Oklahoma can map out a plan to rein in pension costs and obtain an upgrade in its credit rating, the state's lower borrowing costs would free up funds to be invested in other state needs.

Pinpointing the problem

The typical response to Oklahoma's under-funded pensions is that more state funds are needed. But the money being put into the state's pensions is already significant. In fiscal year 2011, total contributions to the state's six defined benefit pension plans were nearly \$1.5 billion.

Financial planners often advise that individuals save 15 to 20 percent of their annual salary for retirement. Private sector employees are sometimes offered a matching employer contribution,

but it's hardly generous. Data from the Bureau of Labor Statistics shows that employers who provide a match contribute between 3 and 5 percent of an employee's annual pay toward their retirement benefits.

Total contributions into the state's defined benefit plans include the amount of pay withheld from the employee, the employer contribution into the system, and dedicated streams of funding from the state, such as a percentage of various taxes. Combining all these sources of funding shows that each of the plans is setting aside at least 20 percent of employees' pay each year, the majority of which is provided by the local employer and the state. Two of the plans are collecting more than double that amount.

The Firefighter's pension plan, which has the highest total contributions at more than 45 percent of employees' salaries, also has the second-worst funding status. The plan with the lowest

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Investment Returns vs. Fees

Plan	5-Year Returns ending 12/31/12	Fees Paid 2011 (Basis Points)
TRS	4.52%	37
OPERS	3.60%	9
Firefighters	2.03%	61
Police	2.41%	66
OLERS	3.10%	46
Judges	3.57%	6
Wildlife	2.24%	19

Source: NEPC, LLC

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Pensions

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contributions as a percentage of salary – the Public Employee Retirement System, at 20 percent, is the third-best funded of the plans.

Clearly, the problem is more complicated than a lack of funding.

Solutions

Between Oklahoma's seven pension plans, there are six independent boards. With this independence comes duplicative personnel, numerous investment and management consultants, and differing investment strategies, with varying levels of risk and results. The boards also set their own discount rates, or estimates of investment earnings, which have become overly-optimistic, artificially understating the plans' liabilities.

Additionally, Oklahoma has the Pension

Oversight Commission, which also hires its own consultant, but whose role is only advisory.

The liabilities of the pension plans are reflected on the state's balance sheet – yet currently, the state has no meaningful say in how those plans are managed. The majority of states have a centralized board that governs their pension plans. If Oklahoma were to streamline its administration into one board, it would likely see up-front savings, but the greater benefit would be in providing accountability for the plans and ensuring that decisions made regarding pensions are in the best interest of not just public workers, but the taxpayers.

Traditional defined-benefit plans offer a lifetime benefit for retirees. The total cost of each retiree's benefit is determined by calculating a number of assumptions: at what age the worker will retire, their ending salary, their

total years of service and how long they will live after they retire. While in theory, each employee's future benefits are pre-funded through employer and employee contributions, the uncertainty of those eventual costs make it difficult to accurately predict.

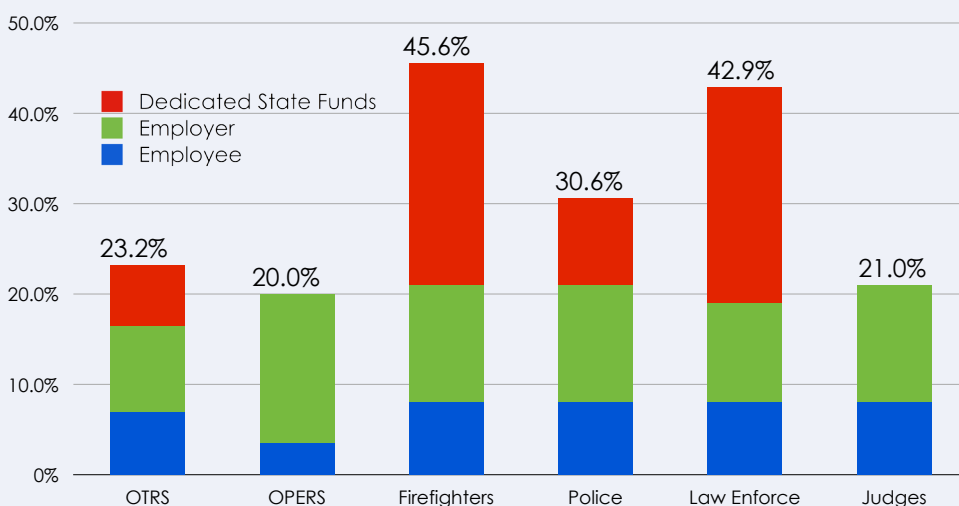
Contrast this with other retirement plans, such as defined contributions, like 401ks, or hybrid plans, like cash-balance options. Under these models, the employee makes contributions which are typically matched by the employer, up to a limit, and those funds are professionally managed for the employee upon retirement.

Private corporations, major manufacturing industries and a growing number of states have moved away from the unpredictable, unsustainable costs of a defined benefit plan and into more stable and predictable plans, where benefits are more closely tied to the actual funds set aside to pay for such benefits.

Several states have closed their defined benefit plans to new hires and created alternative plans that more closely tie benefits to actual contributions. No two state's plans are exactly alike; areas that can be customized include the state's match, who manages the plan and whether the state provides a minimum guaranteed return.

Given the history and current status of its pension plans, Oklahoma's pension problems aren't likely to be resolved without significant and structural changes. Other states have demonstrated there are more sustainable options available; ones that will allow Oklahoma to keep the promises made to past and current workers while offering future workers a benefit that is fair to them and taxpayers alike.

Contributions to Oklahoma Pension Systems
(as percentage of each system's covered payroll)



NOTE: State contributions expressed as percentage of FY-11 covered payroll; regional and four-year universities pay an 8.55% employer contribution rate; Judges contributions scheduled to increase 1.5% each year until reaching 22% in 2019. Source: House Fiscal Staff



Presenting the Oklahoma Treasury Online Checkbook

Oklahoma Treasury Online Checkbook



Oklahoma taxpayers now have a quick and easy way to examine state government's spending with the "Oklahoma Treasury Online Checkbook" launched February 27 by State Treasurer Ken Miller.

"Banks give their customers online access to their accounts; it only makes sense for the state's chief financial officer to provide the same access to Oklahoma taxpayers," Miller told reporters during a State Capitol news conference.

The state's checkbook register can be found by clicking on the online checkbook graphic on Treasurer Miller's homepage, www.treasurer.ok.gov.

Information can be found on expenditures and collections by function of government or by agency. Payments to businesses and state employees are included and can be viewed collectively or searched by individual. Deposits include total receipts by day and by agency, but do not disclose the names of taxpayers.

"This user-friendly tool, which many will find is as easy to use as their own checkbook, is a great complement to Open Books," Miller said.

To demonstrate the ease of using the

site, Miller showed reporters at a State Capitol news conference how to search for information by looking up payments by the state treasurer's office. In about a minute, Miller was able to pull a report of all payments made in December by the agency he heads.

The online checkbook contains almost six million expenditures made since July 2007 and some 200,000 entries of revenue collections since April 2010.

Miller said additional financial data will be added in the coming months. "We will bring more information online as state financial systems are further unified," he said.

Once work is complete on upgrades of the state's cash management and electronic payment and deposit software programs, information on public assistance, pension, unemployment and Medicaid payments will be added to the

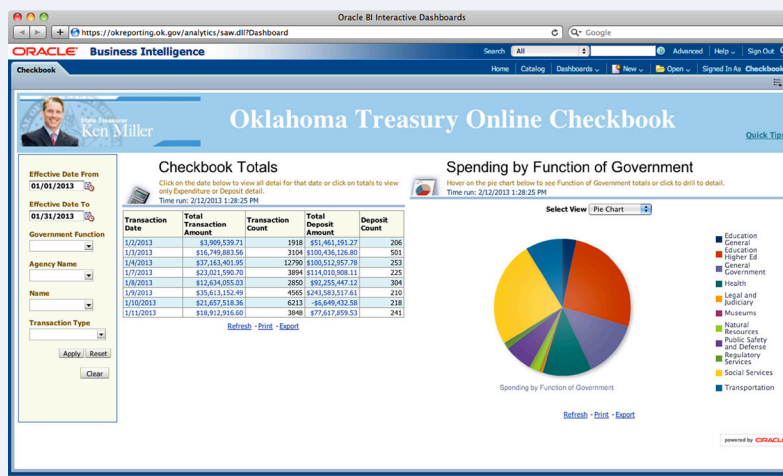
online checkbook. However, recipient information will be blocked to protect the privacy of the individuals receiving the payments. Work is also underway to incorporate

the receipt of federal funds into the automated reporting system.

The Oklahoma Treasury Online Checkbook was developed for the treasurer's office by the Information Services Division of the Office of Management and Enterprise Services.

“Many will find this user-friendly tool as easy to use as their own checkbook.”

A Quick and Easy Look at How State Government is Spending Your Money



This start up screen, available at treasurer.ok.gov, is your portal to detail on where your tax dollars are being spent.



Gross receipts & General Revenue compared

The Treasurer's February 5 Gross Revenue report and the Office of Management and Enterprise Services' February 12 General Revenue Fund (GRF) report contain key differences.

January gross receipts totaled \$1.009 billion, while the GRF received \$578.3 million or 57.3% of the total.

The percentage of monthly gross revenue going to the GRF varied from 34.9% to 57.3% during the past 12 months.

From January gross receipts, the GRF received:

- Personal income tax: 70.3%
- Corporate income tax: 67.8%
- Sales tax: 45.5%
- Gross production-Gas: 46%
- Gross production-Oil: 69.5%
- Motor vehicle tax: 32.5%
- Other sources: 60.2%

January GRF allocations topped the estimate by \$60.5 million or 11.7 percent. In December, collections exceeded the estimate by \$4.4 million or 0.9 percent.

For the month, insurance premium taxes totaled \$26,316.

Tribal gaming fees generated \$11.2 million during January.

January gross receipts make history

Oklahoma's economy reached a number of milestones as it showed expansion in January, State Treasurer Ken Miller said today as he released the state's monthly gross receipts to the treasury report.

"For the first time in Oklahoma history, gross receipts in January exceeded \$1 billion," Miller said. "Income tax withholding set an all-time record as did total sales tax collections."

Miller pointed out that the record collections are a reflection of the strength of Oklahoma's recovery and are in no way related to increased tax rates.

In fact, tax rates have been cut over the past several years.

"This month's treasury report illustrates that Oklahoma's economy is doing

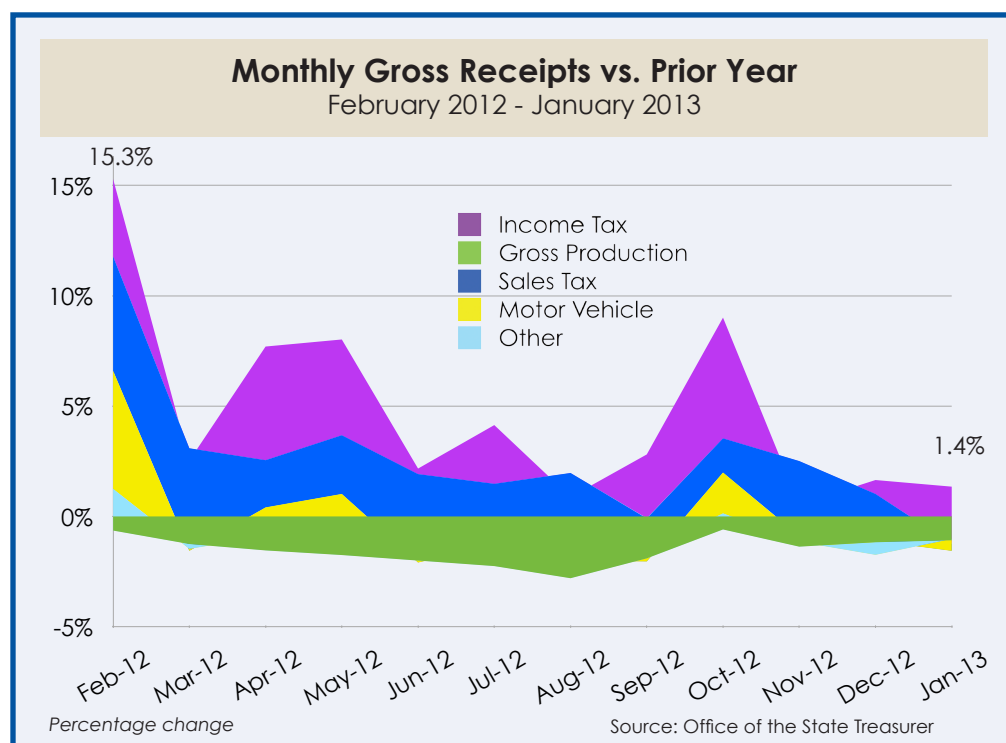
well with individual earnings and spending up more than ever before," he said.

Total gross collections topped \$1.009 billion for the month. Income tax withholding in January was \$268 million. The previous withholding record was \$246.3 million set in January 2012.

Gross sales tax collections this month were \$365.3 million.

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Oklahoma's economy is doing well with individual earnings and spending up more than ever before."





Revenue

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The previous sales tax record was \$364.9 million set in December of last year.

January receipts from all sources grew by 1.4 percent from the prior year and collections for the past 12 months are up by 3.2 percent. Gross production collections in January fell by 15.6 percent from the prior year.

“The state economy is showing its resilience even as collections from the production of oil and natural gas continue to underperform,” he said.

Collections from the past 12 months are \$1.74 billion higher than when gross receipts bottomed out in February 2010.

More than 90 percent of the revenue lost from the peak of the expansion cycle in December 2008 has now been recovered.

Other positive signs

Miller said more positive economic news can be found in the most recent unemployment figures, which set Oklahoma's December unemployment rate at 5.1 percent. That compares to a national rate of 7.9 percent. One year ago, the state's unemployment rate was 6.3 percent.

The latest Business Conditions Index for Oklahoma report bodes well for the state's economy. The January survey shows Oklahoma with a rating of 53.8, compared to 52.1 in December. Numbers above 50 indicate anticipated growth. According to the survey, Oklahoma has among the best performing economies in the region.

January collections

The revenue report for January shows gross collections at \$1.009 billion, up

\$13.45 million or 1.4 percent from January 2012.

Gross income tax collections, a combination of personal and corporate income taxes, generated \$401.64 million, an increase of \$25.67 million or 6.8 percent from the previous January.

Personal income tax collections for the month are \$363.89 million, up \$25.93 million or 7.7 percent from the prior year. Corporate collections are \$37.75 million, a decrease of \$261,000 or 0.7 percent.

Sales tax collections, including remittances on behalf of cities and counties, total \$365.29 million in January. That is \$3.3 million or 0.9 percent above January 2012.

Gross production taxes on oil and natural gas generated \$58.05 million in January, a decrease of \$10.72 million or 15.6 percent from last January. Compared to December reports, gross production collections are down by \$2.12 million or 3.5 percent.

Motor vehicle taxes produced \$55.9 million, up by \$581,000 or 1 percent from the prior year.

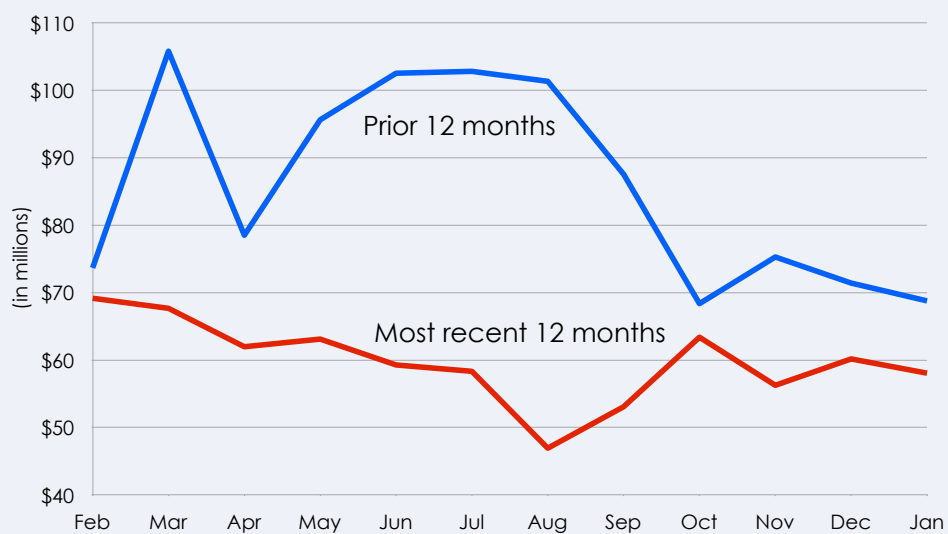
Other collections, consisting of about 60 different sources including taxes on fuel, tobacco, horse race gambling and alcoholic beverages, produced \$128.43 million during the month. That is \$5.38 million or 4 percent less than last January.

Twelve-month collections

Between Feb. 2012 and Jan. 2013, gross revenue totals \$11.1 billion, \$340.73 million or 3.2 percent higher than collections from the prior 12-months.

Gross Production Tax Collections

February 2011 – January 2013



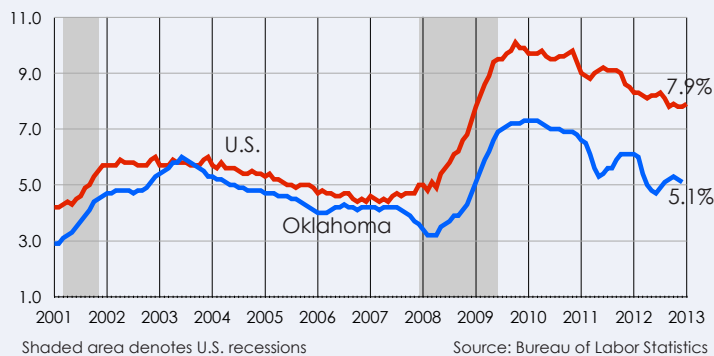
Source: Oklahoma Tax Commission



Economic Indicators

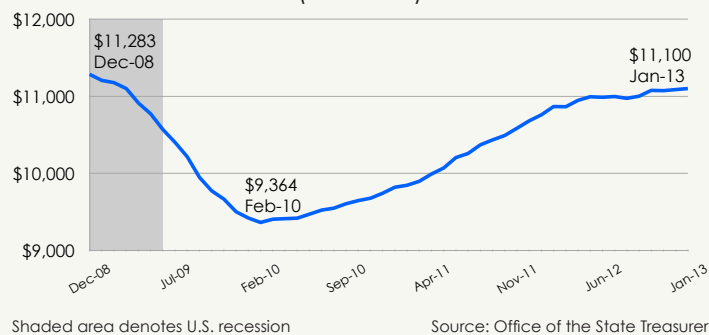
Unemployment Rate

January 2001 – January 2013

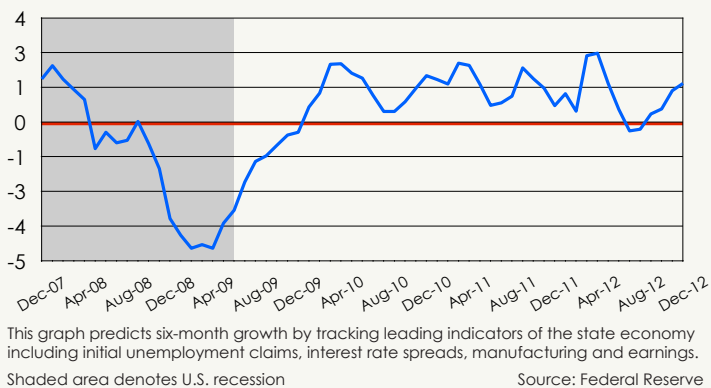


Oklahoma 12-Month Gross Receipts

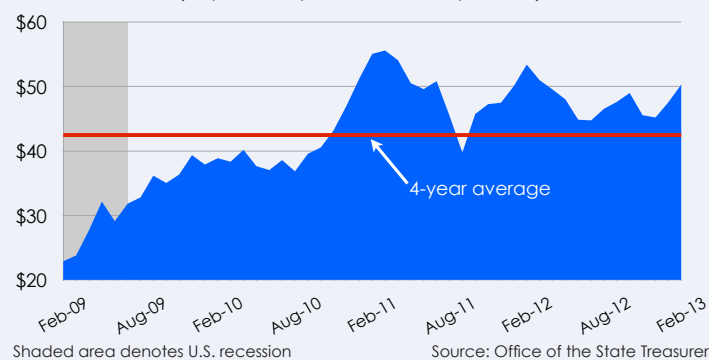
December 2008 - January 2013
(in millions)



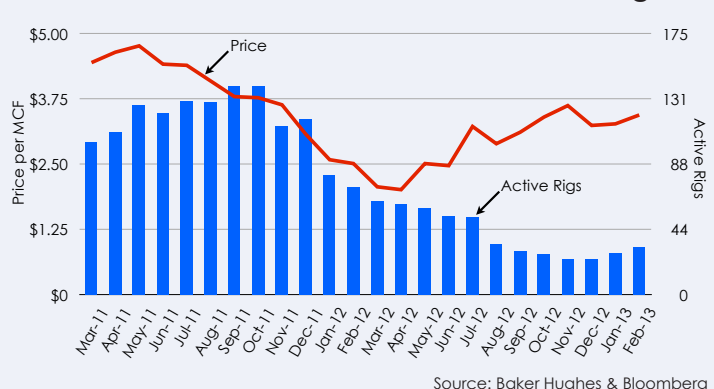
Leading Index for Oklahoma



Oklahoma Stock Index (Top 25 capitalized companies)



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

